LEGAL UPDATE

Department of Labor Proposes to "Update" QPAM Exemption

Marcia S. Wagner, Esq.

One of the most frequently used prohibited transaction class exemptions is Prohibited Transaction Class Exemption 84-14, which provides an exemption for Qualified Plan Asset Managers (the QPAM exemption). The QPAM exemption permits, subject to conditions, plan asset managers of certain investment funds holding assets of retirement plans and individual retirement accounts (IRAs) (referred to collectively as "plans" in the exemption) to engage in transactions with parties in interest to the plans and IRAs invested in the fund. PTE 84-14 is generally regarded as the "benchmark" of prohibited transaction exemptions. However, in light of the increased frequency with which affiliates of QPAMs have been involved in foreign criminal conduct, the Department of Labor (DOL) determined that it was appropriate to propose updates to the exemption affecting the qualification of the applicant. The DOL also wanted to update PTE 84-14 to make it stricter, or generally more difficult to rely on the exemption in certain circumstances not amounting to criminal conduct.

High-level Summary of Proposed Changes to PTE 84-14

1. The DOL proposes to require QPAMs to file a one-time email notification with the DOL (unless there is a change to the legal or operating name of the QPAM) of its intent to be a QPAM, to ensure the DOL is aware of entities

relying upon the QPAM exemption for prohibited transaction relief. The DOL intends to post a list of entities relying on the QPAM exemption on its website.

2. The DOL proposes changes to the events that will trigger a ten-year disqualification of a QPAM. Under the DOL proposal, the listed disqualifying crimes would now explicitly include foreign convictions that are substantially equivalent to the listed U.S. federal or state crimes. In situations where a foreign crime or foreign conduct raises particularly unique issues related to the substantial equivalence test, the QPAM will be able to seek the DOL's view as to whether the foreign crime or conduct is substantially equivalent.
3. The DOL proposal would add five forms of prohibited misconduct that would result in QPAM ineligibility for the ten-year period:

   - any conduct in the United States that forms the basis for a non-prosecution or deferred prosecution agreement that, if successfully prosecuted, would have constituted a listed crime resulting in ineligibility.
   - any conduct that forms the basis for an agreement, regardless of how it is denominated by the laws of the foreign jurisdiction, that is substantially equivalent to a U.S. non-prosecution agreement or deferred prosecution agreement.
   - engaging in a systematic pattern or practice of violating the conditions of this exemption in connection with otherwise non-exempt prohibited transactions.
   - intentionally violating the conditions of the exemption in connection with otherwise non-exempt prohibited transactions.
   - providing materially misleading information to the DOL in connection with the conditions of the exemption.

For the last three categories, the DOL states in the preamble that there would be a DOL investigation, a warning notice to the QPAM and an opportunity to be heard prior to the DOL's issuing an ineligibility notice to the QPAM. With respect to the listed forms of prohibited misconduct, the date of ineligibility would be the date of a DOL ineligibility notice. For criminal convictions, the date of conviction by a trial court is the date of ineligibility. Appeals of the criminal conviction are not taken into account, although the ten-year term may be shortened if the conviction is overturned.

4. QPAMs would be required to include certain obligations in their written management agreements with a client plan if the QPAM, any of its affiliates, or a 5 percent or more owner of the QPAM, engage in conduct resulting in a criminal conviction listed in the exemption, or receive a written ineligibility notice from the DOL because of prohibited misconduct.

The agreement must provide that:

- the QPAM will not restrict the ability of its client plans to terminate or withdraw from the investment fund managed by the QPAM.
- the QPAM will not impose fees, penalties, or charges on any such termination or withdrawal by a plan, except for reasonable fees disclosed in advance that are designed to prevent abusive investment practices or ensure equitable treatment of all investors in a pooled fund, and are applied consistently and in a like manner to all investors.
- the QPAM will indemnify, hold harmless and promptly restore actual losses to any client plan for any damages resulting from a violation of applicable laws, a breach of contract, or any claim arising out of the failure of the QPAM to remain eligible for relief under the QPAM exemption as a result of conduct that leads to a criminal conviction or a DOL ineligibility notice.
- the QPAM will not employ or knowingly engage any individual who participated in the conduct that is the subject of the criminal conviction or DOL ineligibility notice.

These terms must apply for the ten-year period beginning on the ineligibility date.

5. The updated QPAM Exemption would provide for a mandatory one-year windingdown period to accommodate a plan winding down its relationship with the QPAM or withdrawing from its investment fund. According to the preamble, this windingdown period would provide time for a plan to determine whether it wants to hire another QPAM or continue its relationship with the ineligible QPAM serving as a discretionary asset manager.
6. After the mandatory one-year windingdown period, a QPAM cannot rely on the QPAM exemption for any new or existing clients for the ten-year period, but may apply to the DOL for an individual prohibited transaction exemption. The DOL indicated it may condition individual exemptive relief on a certification by a senior executive officer, or comparable person within the now ineligible QPAM, that all of the conditions of the windingdown period were met, and that an independent audit reviewing the QPAM's compliance with the conditions of the one-year windingdown period has been completed.
7. Language in the existing QPAM exemption would be clarified and expanded to provide that a QPAM must not permit other parties to make decisions regarding plan investments under the QPAM's control. The DOL makes clear that using a so-called "QPAM for a day" does not satisfy the requirements of PTE 84-14, since there is

no relief under the exemption for any transaction that has been planned, negotiated or initiated, in whole or in part, by a party in interest to the plan, and presented to the QPAM for approval, because the QPAM would not have sole responsibility with respect to the transaction.

8. The DOL proposes to update the QPAM's eligibility thresholds for assets under management and for equity capital, which have been in place since 1984, and proposes that the threshold determinations will be updated annually. The $1,000,000 threshold for the equity capital of banks, savings and loan associations, and insurance companies has been increased to $2,720,000; the current assets under management threshold for RIAs is increased from $85,000,000 to $135,870,000; and for RIAs' two additional optional conditions—the shareholders and partners equity threshold and the broker-dealer net worth threshold—has been increased from $1,000,000 to $2,040,000.
9. QPAMs would be required to maintain for six years records demonstrating compliance with the QPAM exemption, and the records generally must be available to the federal agencies, plans, and plan participants.

Questions About the Proposed Changes to PTE 84-14

Our questions and concerns include the following:

- Many provisions go beyond just addressing bad actors, foreign convictions and exemption ineligibility—for instance, the new proposed thresholds for assets under management and for equity capital. These higher thresholds, and the burden of annual required updates, will be difficult to achieve for smaller QPAMs.
- New recordkeeping requirements add significantly to the burden of compliance, without any significant justification. Also, we note that the DOL proposes to require disclosure of most QPAM compliance records to plans and participants—a level of disclosure also proposed, but then not adopted for PTE 2020-02 (class exemption for investment advice).
- Clarification is needed on the exemption when it is used by a QPAM for hiring service providers—namely, what is an investment transaction versus a non-investment transaction?

In general, the DOL does not provide much guidance on some of the more complex new obligations—such as that the QPAM must state in its agreements that, if it becomes ineligible for the exemption, it will indemnify affected plans, and not restrict their movement out of the arrangement. This latter proposal, for instance, will require significant rewriting of QPAM agreements, will be difficult to administer and may have a negative effect on other investors in some types of investment funds. Similarly, the proposed indemnification imposes significant and questionable new liability on QPAMs found to be ineligible for the exemption.

* * * * *

The DOL has given interested parties until September 26, 2022, 60 days from the date of publication, to provide comments on the proposed changes to PTE 84-14.

Marcia S. Wagner *is the Managing Director of The Wagner Law Group. She can be reached at 617-357-5200 or* Marcia@WagnerLawGroup.com.